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**From:**

**Sent:** Monday, March 15, 2010 6:18:21 PM

**To:**

**Cc:**

**Subject:** RE: FTC Question

Taxpayers claiming foreign tax credits on the cash basis properly claim credit for accrued foreign taxes in the year paid, even if the liability accrues in an earlier or a later tax year (when the all-events test is met under Treas. Reg. 1.461-4(g)(6)(iii)(B)). However, to claim the credit (whether in the year paid or the year accrued) the taxpayer must establish that the amount paid did not exceed the amount owed under a proper interpretation of foreign law. See Treas. Reg. 1.901-2(e)(5). Section 905(c)(1)(C) requires a redetermination of US tax to reduce the foreign tax credit claimed if the foreign tax is refunded in whole or in part. So you are correct that the taxpayer was obligated to file amended returns for the affected years and pay the resulting US tax deficiency when the foreign taxes previously paid and claimed as a foreign tax credit were refunded. Interest is due on the resulting US tax deficiency to the extent the foreign country paid interest to the taxpayer, and for periods after the refund was received. See section 905(c)(5).

If the foreign country later determines that the refunds were paid in error and the foreign taxes are subsequently repaid at the conclusion of a foreign audit, then the cash basis taxpayer would be entitled to claim a credit for foreign taxes properly due and paid in the later year when paid. Such payments would only "relate back" to and be creditable in the earlier year in which originally paid if the taxpayer used the accrual method of accounting for creditable foreign taxes. Cuba Railroad Co. v. United States, 124 F. Supp. 182 (S.D.N.Y. 1954), aff'd, 254 F.2d 280 (2d Cir. 1958); Rev. Rul. 84-125, 1984-2 C.B. 125. Since your taxpayer is on the cash basis, the US tax must be redetermined and additional US tax paid for the years in which credits were claimed for foreign taxes previously paid that have been refunded. No foreign tax credit will be allowed in those prior years for the refunded taxes, regardless of the ultimate outcome of the foreign contest.

Note that under section 905(a) a cash basis taxpayer may make a one-time election to claim credits on the accrual basis, but this election is irrevocable, so the taxpayer may not switch back to the cash basis in a later year. Also, a change in election from the cash basis to the accrual basis cannot be made on an amended return. See Strong v. Commissioner, 36-1 USTC 9032; cf Rev. Rul. 59-101, 1959-1 CB 189.

Please call if you have additional questions.